

International Estate Planning: A Primer

by

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Overview

Most practitioners focus on the tax issues when more than one country is involved, so part one of this paper will address the most relevant tax issues. The first section of part one is a summary of the application of the U.S. estate and gift tax to U.S. citizens, U.S. “residents”, and nonresident aliens. The second section of part one is a summary of the application of other countries’ wealth transfer taxes to U.S. persons. That section includes a review of the estate tax treaties to which the United States is a party, which are intended to eliminate double taxation. Non-tax issues, including Hague conventions, are addressed in the second part. The field of international estate planning is extremely complex. This paper is intended as a basic primer.

I. U.S. Estate and Gift Tax Jurisdictional Reach

The United States imposes its estate and gift tax on three separate and distinct jurisdictional bases: 1) citizenship, 2) “domicile” and 3) the situs of the assets. The first two are referred to in the initial Code section for the estate tax:

“A tax is hereby imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.”

Internal Revenue Code Section 2001.

A. Citizenship—The First Jurisdictional Base

With the exception of the Philippines, the United States seems to be unique in applying its wealth transfer taxes on a worldwide basis to those whose only connection with the United States is that they are citizens of the United States.¹ This means that those who have U.S. citizenship are fully subject to the U.S. estate and gift tax even if they have never lived in the United States and own no assets that are deemed to be located in the United States. Because other countries tax worldwide only if the taxpayer is “domiciled” or “resident” in that

¹ A few countries, such as Sweden, may apply their inheritance tax for a certain number of years to nationals who leave the country and take up residency elsewhere.

country (with a variety of definitions) the U.S. reach based solely on citizenship comes as a great surprise to many clients.

One of the most common ways to become a U.S. citizen is to be born in the United States (which applies even if the birth occurred while the mother was here on a brief vacation) or to be born outside of the United States but with one or both parents who were U.S. citizens. The exact requirements have changed several times over the years, so one must be careful to find the law that would apply to a particular birth.

It is clear that the United States will recognize multiple nationalities held by a single person. What is important to remember is that the existence of U.S. citizenship, even in combination with one or more additional nationalities (even those often thought of as “primary” by the client) is sufficient to subject the client to worldwide taxation. It is not uncommon to learn that an otherwise “foreign” person also has an American passport. The passport is given only to citizens.

→ *Trap: Many United States citizens, especially dual citizens and those living in other countries, do not know that their worldwide assets are subject to the transfer taxes of the United States.*

→ *Tip: Ask all clients about their citizenship, and whether they have more than one (including passports).*

B. Residency (“Domicile”)—The Second Jurisdictional Base

The Internal Revenue Code uses the term “resident” in the application of the federal estate and gift tax. In the regulations, however, it is clear that the actual meaning is one of “domicile”. The exact wording in the regulations is:

“A ‘resident’ decedent is a decedent who, at the time of his death, had his domicile in the United States. . . .A person acquires a domicile in a place by living there, for even a brief period of time, with no definite present intention of later removing therefrom.

Residence without the requisite intention to remain indefinitely will not suffice to constitute domicile, nor will intention to change domicile effect such a change unless accompanied by actual removal.”

Treas. Reg. 20.0-1 (b)(1).

→ *Trap: This is an entirely different test than the test for “residency” for U.S. income tax purposes, which is a “count the days” test based on physical presence in the United States.*

→ **Tip:** One must always be cautious to read the definitions of “domicile” applied by any country: there are a fair number of variations in the meaning. The domicile definitions in the United Kingdom, for example, are particularly complex.

1. Physical Presence

The definition of domicile for the U.S. estate and gift tax requires physical presence (i.e. living there), “for even a brief period of time” in the United States.

2. Intention

The second required prong of the definition of domicile is that the physical presence was “with no definite present intention of later removing therefrom”.

Key cases, which illustrate the factors that can be considered by a court include:

- Estate of Nienhuys v. Commissioner, 17 T.C. 1149 (1952) (could not return to the Netherlands due to war, then food and fuel shortage, then illness, bought only “light, inexpensive furniture” in the U.S., did not join a church in the U.S., ashes taken to Holland, etc.);
- Estate of Paquette v. Commissioner, T.C. Memo 1983-571 (1983) (Canadian who spent winters in Florida, then retired to Florida but kept one home in Canada, voted in Canada, filed income tax returns in Canada, kept Canadian driver’s license and car registration, widow testified that he intended to keep his Canadian domicile, etc.);

- *Cooper v. Reynolds*, 24 F.2d 150 (1927) (had begun building a home in Wyoming, took part in local civic enterprises, invested in local securities, and told several people that he intended to make his residence in Wyoming);
- *Forni v. Commissioner*, 22 T.C. 975 (1954) (Italian who tried to reside in the U.S. for limited purpose of receiving and transferring funds the U.S. would not transmit to Italy); and
- *Estate of Kahn v. Commissioner*, T.C. Memo 1998-22 (1998) (Pakistani who could not speak English held to be domiciled in U.S., despite wife and children remaining in Pakistan, returning and dying in Pakistan (without having purchased a return ticket to the U.S.), filing nonresident U.S. income tax returns, and letting his reentry permit expire).

As the Kahn court remarked in the close of its opinion: “No one, except the individual, knows or can know with absolute certainty whether, in fact, he chooses to abandon his domicile and adopt a new one.”

One indication of an intent to remain in the U.S. is to apply for a “green card”. Indeed, it would be difficult² for a green card holder to prove that there was no intention to “reside” in the United States.

An interesting recent case on this issue is *Estate of Robert A. Jack v. United States*³. The decedent had been in the United States on a “TN Temporary Professional” visa. He would have been in violation of his visa if he did intend to stay in the United States. The issue before the court was whether that intention was impossible as a matter of law, or whether it was subject to an evidentiary hearing. The court denied the motion for a partial summary judgment, stating: “The decedent may have developed the intent to be domiciled in the United States although that would have put him in violation of the terms of his visa.”

² Although not impossible, depending on the particular circumstances.

³ U.S. Court of Federal Claims, No. 01-410T (filed Nov. 27, 2002).

→ *Trap: This is a highly subjective test, based on a client's intention.*

→ Tip: Clients for whom this could be important should try to document their intent in a number of ways.

3. Scope of Tax for “Domiciliaries”

Once these two requirements (physical presence and intention) are met, then it no longer matters if the person remains in the United States. The U.S. estate and gift tax⁴ will apply to transfers made by these “domiciliaries” regardless of where they live (or die) and regardless of the fact that all of the assets may be located outside of the United States.

Interestingly, even an illegal immigrant who has no legal right to be in the United States but whose intent can be shown to be to “stay” in the United States can be (and has been) fully subject to the U.S. estate tax at death, on a worldwide basis.⁵

It is certainly possible for more than one country concurrently to claim someone as domiciled in that country. Apart from the possibility of treaty relief, there is no international body that would limit the claim of domicile to only one country.

C. Situs of Assets—The Third Independent Jurisdictional Base

The third separate and distinct jurisdictional base is the location of the assets, as determined by the United States. As stated in Code Section 2103:

“For the purpose of the tax imposed by section 2101, the value of the gross estate of every decedent nonresident not a citizen of the United States shall be that part of his gross estate (determined as provided in section 2031) which at the time of his death is situated in the United States.”

⁴ The generation-skipping transfer tax will apply only if the estate or gift tax would apply.

⁵ See, e.g., Rev. Rul. 80-209.

In the Internal Revenue Code certain assets are deemed to be located within the United States, certain assets are deemed to be located outside the United States, and the remaining categories of assets are not mentioned at all. The importance of the determination of the location of the assets is that those considered, by the United States, to be located within the United States will be subject to the U.S. estate and gift tax even though the owner/donor/deceased is not a U.S. citizen and is not a domiciliary of the United States.

→ *Trap: Many foreign holders of U.S. assets are unaware of the potential U.S. estate (and gift) tax consequences.*

→ *Tip: Review carefully the exact language of Code Sections 2104 (“within”) and 2105 (“without”).*

1. Land/Homes

One of the easier categories of assets to “locate” is physical land, and related homes. Those assets are deemed to be located in the United States if they are physically situated in the United States. (This is not in the Code, but is in the regulations).⁶ There are a few questions that arise when different “appurtenances” to land are involved.

→ *Tip: If possible, the nonresident alien would usually be in a better position if he or she did not own U.S. real property directly. For example, if such property were purchased by a foreign corporation owned by the nonresident alien, he or she would not own U.S. assets for U.S. estate tax purposes.*

2. Tangible Personal Property

This category is also set forth only in the regulations (which except art on loan for exhibition). Treas. Reg. 20.2104-2 (a) (2).

→ *Trap: Currency and cash may be tangible personal property.*

⁶ See Treas. Reg. 20.2104-1 (a) (1).

→ Tip: Advise that such gifts take place outside of the United States, or transfer an entire account as a gift of an intangible.

3. Corporate Stock

Securities in a corporation are deemed to be located in the state under the laws of which the corporation was organized.

→ *Trap: This often comes as a surprise to those outside the U.S. whose portfolios contain U.S. securities.*

→ Tip: To answer a common question, yes these transfers are enforced quite well, at least for publicly traded securities. The registered transfer agent will request a certificate showing that the appropriate tax has been paid (otherwise the transfer agent could be responsible for the tax).

4. Bank Accounts

Bank accounts, if they are “general deposit” accounts and are with U.S. “banks” (or foreign branches of U.S. banks) are exempt from the estate and gift tax that would otherwise apply when owned by nonresident aliens. Thus general deposit bank accounts with U.S. banks, held by NRAs receive a very favorable tax treatment.

5. Qualified Portfolio Debt Obligations

One of the more difficult Code sections is the one excluding from the estate tax qualified portfolio debt obligations held by an NRA. The cross-references involve a bit of work, but a simplified interpretation is that government bonds and corporate bonds are generally exempt from both income tax and estate tax when held by nonresident aliens. Again, this may reflect a policy decision by the United States, which favors “loans” from foreigners as opposed to “ownership” in the underlying equity growth.

→ Tip: Review (carefully) the U.S. investments held by a nonresident alien client to see whether some are (or could be) exempt.

6. Life Insurance

Another interesting exemption is that the proceeds of life insurance on the life of a nonresident alien, owned by that insured person, are exempt from the U.S. estate tax even when issued by a U.S. life insurance company.

→Tip: Consider using life insurance whenever a nonresident alien would be subject to the U.S. estate tax. They may own it outright and still have the proceeds excluded from the estate tax.

7. Partnerships

Partnerships are not listed either in the “within” category or in the “without” category. Thus whether they will be treated as situated within the United States or not is somewhat unclear.

D. Taxation of Nonresident Aliens

If someone is not a citizen of the United States and is not a domiciliary, as defined by the estate and gift tax regulations, then the only assets that would be subject to the U.S. estate and gift tax are those assets that are deemed to be situated within the United States.

1. “U.S. Assets”

The nonresident alien client (“NRA”) will only be subject to the U.S. estate and gift tax with respect to those assets that are considered, by the Internal Revenue Code, to be situated within the United States. Several of those categories have been described above.

2. Rates

Once there are assets subject to the U.S. estate and gift tax, the tax is calculated under the same rates as the rates that are used for U.S. citizens and domiciliaries. (Years ago, the rates used for NRAs were different, but that is no longer the case.)

3. Exemption Amount

The amount that is exempt from the estate tax is only \$60,000 for a NRA, as contrasted with the current \$1,000,000 exempt amount for a U.S. citizen or domiciliary. (Note: This amount was not changed by the Economic Growth and Tax Reconciliation Act of 2001.) If the assets that are deemed to be located in the United States have an aggregate fair market value in excess of \$60,000 then a federal Form 706NA must be filed.

→ Trap: Unlike the ability of a U.S. person to apply the applicable credit exemption amount during the process of making lifetime gifts, the NRA who makes taxable lifetime gifts may not take advantage of this procedure.⁷

4. Pro Rata Debt Inclusion

Many foreign clients (NRAs) assume that they need only count the net value of their vacation homes within the United States. In other words they assume that they may subtract the amount of the mortgage or other debt on the property.

This is true only in the rare case that the debt is truly “non-recourse”. In all other cases, the full fair market value of the property, unencumbered by debt, must be reported. The amount of the mortgage or other debt may be claimed on a pro rata basis: the fraction of the total debt that is equal to the ratio that the U.S. assets bear to the total worldwide assets may be subtracted on the Form 706 NA.

→ Tip: This means that the total value of all worldwide assets must be disclosed, resulting in the fact that most foreign clients decide to forgo the debt deduction.

5. Deductions in General

In general, regular deductions are available for the NRA, but limited to the proportion of the expense that relates to the proportion of the United States assets to the total worldwide assets. See comment above.

⁷ See Code Section 2005: “In the case of a citizen or resident of the United States, there shall be allowed as a credit against the tax imposed by section 2501 for each calendar year. . . .” (emphasis added).

6. Charitable Deduction

For NRAs the charitable deduction is allowed, from the U.S. taxable assets, only if the charity is either a U.S. charity or if the property is to be used only within the United States. See Section 2106 (a) (2) (A) (ii) and (iii). Note that the proportionate limit does not apply to the charitable deduction.⁸

7. Gift Tax Exclusion for Intangibles

There is a specific exemption for gifts of U.S. intangibles (such as corporate securities of U.S. corporations) made by NRAs. Those lifetime gifts are exempt from the U.S. gift tax.⁹ By contrast, if the NRA dies holding those assets, they are fully subject to the U.S. estate tax.

→Tip: Consider having the NRA make lifetime gifts of U.S. intangible assets, to avoid the U.S. estate tax on those assets that would be imposed if those assets were still owned at death by the NRA.

→Trap: Consider the application of foreign transfer taxes prior to making gifts.

E. QDOTs (“Qualified Domestic Trusts”)

In 1986 Congress enacted a law eliminating the standard marital deduction in the case where the surviving spouse is not a citizen of the United States. The rationale for this severe treatment was that such a spouse would be free to leave the United States and take any inherited assets out of the United States. This would have the effect of transforming what had been intended as a mere “deferral” of the married couples’ full estate tax (i.e. by waiting until the death of the survivor to impose the full estate tax) into an “escape” from the estate tax entirely. This is because if the surviving spouse was not a U.S. citizen it would be fairly easy (and it was thought to be not unlikely) to leave the United States, with the inherited assets. In that case, none of the three jurisdictional bases (citizenship, domicile, or situs of assets) would apply.

⁸ Code Section 2106 (a) (2) (D).

⁹ Code Section 2501 (a) (2).

To prevent this potential “escape” the new rules required that if the marital deduction were to be allowed it would be only with respect to assets that were transferred to a new entity, a “Qualified Domestic Trust”. See Code Section 2056A.

1. U.S. Trustee

One of the key requirements of a QDOT is that there be a U.S. taxpayer who acts as Trustee, with the ability to withhold the estate tax that would be due upon each distribution of principal.

2. Bank or Bond

For “large” QDOT trusts (those with assets of more than \$2 million) there is an additional requirement that either a bank must be the U.S. Trustee or there must be a performance bond. In practice it seems that everyone chooses the bank option, as the bonds would be rather expensive.

3. Calculation of Tax

Unlike the tax on a standard marital trust, where the balance remaining at the death of the surviving spouse is included in the taxable estate of that second spouse to die, the tax on the balance of the QDOT (as well as the tax on any distributions of principal during the term of the QDOT) is calculated as if those amounts had been included in the estate of the first spouse who died.

4. Subsequent Citizenship

If the surviving spouse does become a U.S. citizen prior to the time when the estate tax return (either the 706 or the 706-NA) is filed, then the standard marital deduction would be available.

5. Joint Property

As part of the change that eliminated the standard marital deduction in the case where the surviving spouse is not a U.S. citizen, the standard rules that would otherwise apply to property that is jointly owned by a married couple were also changed. Instead of treating

one-half of the value of the jointly owned property as being included in the estate of the first spouse to die, the rule that applies to a non-U.S.-citizen surviving spouse is to treat the entire value of jointly owned property as being included in the estate of the deceased spouse. This presumption is subject to rebuttal by the surviving spouse, upon proof of contribution to the property.

6. Annual Gifts to a Non-citizen Spouse

A final change worth noting is that although the unlimited gift tax exclusion that would otherwise apply to gifts from one spouse to another was eliminated whenever the recipient spouse is not a U.S. citizen, the standard \$10,000 exclusion from the gift tax was increased to \$100,000 per calendar year for gifts to a non-U.S. citizen spouse.¹⁰ That indexed amount was \$110,000 in 2002.

→Tip: Consider making the annual gifts of up to \$100,000 (as indexed, which was \$110,000 in 2002) to the non-U.S. citizen spouse. Those assets could then be held by the non-citizen spouse free of the QDOT restrictions.

F. Offshore Trusts

1. Presumption of Foreign

In 1996 new provisions were added to the Internal Revenue Code to define a “foreign” trust. Those sections provide that all trusts are foreign, unless they meet the new requirements for a “U.S.” trust, described below.¹¹

2. Court and Control

There are now two requirements that must both be met in order for a trust to be treated as a U.S. trust. If both requirements are not met, the trust will be a “foreign” trust.

¹⁰ Code Section 2523 (i) (2). (adjusted for inflation).

¹¹ Code Section 7701 (a) (30) (E).

The “court” test is that a U.S. court must be able to exercise primary supervision over the administration of the trust. (A “U.S. court” includes a court within any state or the District of Columbia, but not one within a territory or possession the United States.)

The “control” test is that one (or more) U.S. persons must have the authority to control all of the “substantial” decisions of the trust.

3. U.S. Beneficiaries

Special tax rules apply when there are U.S. beneficiaries of “foreign” trusts. Also, Form 3520-A must be filed.

4. Asset Protection Trusts

An increasingly popular offshore trust used by U.S. persons is a trust that is not drafted in a way that would cause any transfer tax, or any shift in the income tax on the trust assets. Instead, the primary purpose of those trusts is to attempt to shield the trust assets from future claims by potential creditors.

A number of offshore jurisdictions have been changing their laws in an effort to attract this business. The OECD has a number of initiatives against the “offshore financial centers” which have had many recent changes. Such a trust must be carefully analyzed from a bankruptcy law perspective.

G. Expatriation

Although there were a number of proposals a few years ago to impose a new tax upon those who give up their U.S. citizenship for tax-motivated purposes. The “exit tax” did not pass. There has been legislation proposed again, most recently in Senate Bill 19, so this is an area that may change.

1. Estate and Gift Tax Consequences

Instead of the “exit tax”, there is now a somewhat expanded definition of the control over a foreign entity that owns U.S. assets, as to which there will be a proportionate tax during the ten-year period following the expatriation.¹² In almost all other respects the expatriate will be taxed under the estate tax in the same manner as are other nonresident aliens.

In addition, the ten-year tax treatment rules will also apply to certain long-term “green card” holders who give up their green card. If they had a green card in at least eight of the preceding fifteen years, and surrendered it with tax motivations as a principal purpose they will be treated for most purposes in same manner as someone who relinquished citizenship for similar reasons.¹³

Note: During that ten-year period an expatriate is unable to exclude lifetime gifts of U.S. intangible assets from the U.S. gift tax.

2. Immigration Provisions

As part of the changes made to address expatriation for tax motives, a new section was added to the immigration provisions. As originally passed the provision stated that a former citizen who had been found to have been a “tax-motivated” expatriate would be “excludable” from the United States. As the language now stands, however, the word “excludable” has been changed to “inadmissible”.

Note: This means that a “tax-motivated” expatriate could be prevented from entering the United States. (Apparently, this provision has not been enforced in practice, as of the current time.)

H. Receipt of Foreign Gifts

Although there is no gift tax in the United States upon the receipt of a gift, there is a requirement to file Form 3520 if a U.S. person receives more than \$100,000 from a foreign individual (including related foreign persons) as a gift (or gifts), more than \$100,000 from a

¹² There are also many reporting requirements.

¹³ Code Section 877 (e) (2).

foreign estate (including related foreign persons), or any amount from a foreign trust, in any one calendar year.

II. Potential Foreign Estate, Gift, Inheritance, or Other Tax

A. Examples of Foreign Taxes

1. Inheritance Tax

Outside of the United States (and other common law countries) the majority of jurisdictions impose their tax at death upon those who inherit the property. This is referred to as an inheritance tax.

→ *Trap: For clients from European countries, with a Civil Code, the concept of a decedent's "estate" will be quite unfamiliar to them.*

2. Wealth Tax

Another tax that affects wealthy individuals on an annual basis is a "wealth" tax. That tax is imposed each year, based on a percentage of the value of all of the assets that the individual owns.

→ *Trap: In France, for example, the annual wealth tax also applies to those who do not reside in France but who own property located in France (in that case the tax applies only to the assets in France).*

3. Jurisdictional Basis Variations

One must also consider the jurisdictional basis for a foreign tax. In some jurisdictions, it is the domicile of the beneficiary that is relevant. In other jurisdictions, it is the domicile of the decedent that is critical and it is irrelevant where the beneficiaries live.

B. Unilateral Relief

If a foreign wealth transfer tax applies, one avenue for relief is to consider the availability of unilateral relief.

1. Foreign Death Tax Credit

There is a specific Internal Code Section that describes the nature and extent of the “credit” that is available against the U.S. estate tax for the payment of a “foreign death tax”. See Code Section 2014.

2. Debt (Deduction)

If for some reason it is not possible to use the foreign death tax credit, it should still be possible to deduct the amount of a foreign tax that is owed, as a debt owed by the estate. Of course, a deduction does not provide as much benefit as would a credit.

C. Estate Tax Treaties

An additional avenue for relief from double taxation is to determine whether or not there is an estate and/or gift tax treaty between the United States and the other country. If there is, it may be possible that the treaty would provide some tax relief.

→Tip: If two or more other countries are involved (in addition to the United States), each country should be checked, as the treaties to which the United States is a party are only “bilateral” in nature.

1. The Sixteen Estate Tax Treaties

Following is a list of the sixteen current estate tax treaties to which the United States is a party. If gift taxes are included, that is indicated as well.

Australia - Estate and Gift Tax Treaty (**Note:** since Australia later repealed its estate tax, this treaty is of no practical effect)

Austria - Estate and Gift Tax Treaty

Denmark - Estate and Gift Tax Treaty

Finland - Estate and Gift Tax Treaty

France - Estate (and Gift) Tax Treaty

Germany - Estate and Gift Tax Treaty (Note: as of December 2000, there is also an amendment to this treaty)

Greece - Estate Tax Treaty

Ireland - Estate Tax Treaty

Italy - Estate Tax Treaty (Note: Italy has repealed its inheritance tax.)

Japan - Estate and Gift Tax Treaty

Netherlands - Estate Tax Treaty

Norway - Estate Tax Treaty

Union of South Africa - Estate Tax Treaty

Sweden - Estate and Gift Tax Treaty

Switzerland - Estate Tax Treaty

United Kingdom - Estate and Gift Tax Treaty

2. Canada Income Tax Treaty--Third Protocol

The United States did have an estate tax treaty with Canada, but then Canada repealed its estate tax. In 1971 Canada replaced its death tax with a change in its income tax laws that provided, in general, that upon death a person would be treated for income tax purposes as if he or she had sold or disposed of all of his or her assets, resulting in an income tax calculated with reference to the appreciation of those assets.

For a number of years it was no longer possible to eliminate the double taxation by the United States and Canada because there was no “death tax” on the part of Canada. Finally, this gap was addressed by an amendment in 1995 (the third “protocol”) to the income tax treaty between the United States and Canada. The Protocol also allows a proportionate share of the “unified credit” to be allowed against the United States tax (based on the proportion of assets in the United States), and allows a “marital credit” against the U.S. tax when the surviving spouse is not a U.S. citizen (but limits the credit, in general, to the proportionate amount of the “unified credit” that is allowed under the Protocol).

III. Overview of Non-tax Issues

Although they are not given as much attention as the tax issues receive, there are a number of extremely critical non-tax issues that must be considered whenever more than one country is involved in the wealth transfer planning for an individual.

IV. Non-recognition of Trusts

→ *Trap: Probably the single most important “trap” for U.S. practitioners is the fact that many countries simply do not recognize the concept of a trust.*

A very common area in which this arises is when a well-meaning U.S. practitioner attempts to avoid probate (which may not even be an issue in the other country, as discussed below) in another country by transferring foreign assets to a standard U.S. revocable trust.

What is making this traditional problem much more serious in recent years is the requirement in the Internal Revenue Code that in order to receive a marital deduction, bequests left to a non-U.S. citizen spouse must be held in a trust.

→ *Tip: Before making any transfer of foreign assets to a trust, contact knowledgeable counsel in the other country and review all the related issues.*

A. Civil Law Jurisdictions

Civil law countries (which include all of Western Europe) do not recognize the legal concept of a trust (with the exception, to some extent, of the few that have adopted the Hague Convention on the Recognition of Trusts, discussed below).

B. Potential Consequences

There are a number of serious adverse consequences that can result from the attempted use of a trust in a jurisdiction in which the trust concept is not recognized.

1. Higher Tax Rates

One of the most serious adverse effects is to cause an increased inheritance tax in the other country. This is because the rate of tax is usually determined by the degree of closeness of the relationships between the deceased and the beneficiary of the inheritance. If a “stranger” to the family tree, or a corporation, is named as Trustee, the highest possible inheritance tax rate will probably be applied.

2. Tax Upon Transfer to Revocable Trust

Another very unfortunate consequence is that the actual transfer itself of the ownership of a foreign asset to a standard U.S. revocable trust can trigger an immediate tax in the other jurisdiction. This happens, for example, upon the transfer of an appreciated asset located in Canada. The transfer itself will cause an immediate income tax (calculated upon the appreciation of that asset).

3. Exposure to Trustee’s Creditors

If the foreign jurisdiction does not recognize trusts, there is a risk that the trust assets will be treated as if they are personally owned by the trustee. As such, they could be subject to any claims of creditors of the trustee.

4. Claims by Trustee’s Heirs

As a corollary to the above point, if the foreign assets are treated as if they are owned individually by the Trustee, there is also a risk that the heirs of the Trustee could claim their inheritance rights against the trust assets, upon the death of the Trustee.

V. Lack of Probate

In civil law jurisdictions the concept of “probate” is not a familiar one. There is instead an “immediate” inheritance by the heirs, of the assets as well as the liabilities (unless a procedure is used to examine the assets and liabilities first). As they say in France: “Le mort saisit le vif.”

VI. Forced Heirship

In civil law jurisdictions there are also rules about the rights of children to inherit a fixed portion of the parent's estate. Again, whether or not those rights will be enforced may depend upon the forum in which a particular issue is presented. For example, in the well-known New York case of *Renard*.¹⁴ the son was unsuccessful in claiming that he was entitled to a forced share in his French mother's estate when she had been domiciled in France but signed a Will that specified that New York law would govern.

The manner in which forced heirship rules operate can vary considerably by country. The amounts can differ, the lifetime freedom of disposition by gift may have differing restrictions, and in some cases amounts that have been given away during lifetime can be "clawed back" into the estate. As with other issues of this nature, a knowledgeable practitioner in the other country should be consulted.

VII. Marital Property Regimes

As an initial matter, one needs to consider whether or not a married client, particularly one from another jurisdiction, in fact has the legal right to control the inheritance of all of his or her property. This is another area that can be extremely complex.

If there is a "marital property" regime the spouse may normally dispose of only his or her separate property interest. Those regimes vary considerably, and it is not always easy to determine which regime will apply. (Keep in mind, also, that there may be forced heirship rights as well, which could result in there being only a small percentage of property that the client could dispose of by Will.)

VIII. Family Legal Definitions

There are a variety of issues that can be involved with respect to the family legal relationships. These would include:

- Would the spouse be recognized as such?

¹⁴ Estate of Renard, 437 N.Y.A.2d 860 (1981).

- Was there a prior divorce that would not be recognized?
- Would a polygamous spouse be recognized?
- Would a “common law” spouse be recognized?
- Would a “same sex” spouse be recognized?
- Will an adopted child be recognized?
- Will an illegitimate child inherit?
- Would a child conceived (by artificial means) after the parent’s death be recognized as his or her child?

IX. Override by Family Protection Acts

There are an increasing number of jurisdictions that have passed legislation under which a challenge may be made against a Will that someone was not treated “fairly”. Usually entitled some form of “family protection act”, these can be used to override the terms of a Will.

X. “Situs” or Multiple Wills

Another very difficult issue is whether a client should have more than one Will in effect at the same time. Sometimes this is suggested to make the transfer of land in another jurisdiction simpler. The drafting of any multiple Wills requires extreme care. For an extensive discussion, see “The Use of Multiple (“Situs”) Wills” in [A Guide to International Estate Planning](#) (ABA, Real Property, Probate and Trust Section, 2001).

XI. Durable Powers of Attorney and Living Wills

Many documents drafted for local use will not be recognized or given effect in other jurisdictions.

→ Tip: Ask local counsel about any particular such document.

XII. Conflict of Laws/ Choice of Law

As can be seen, the multitude of issues involved in the non-tax aspects of international estate planning require frequent reference to the question of which jurisdiction will apply its laws to a particular issue, and in which circumstances a jurisdiction will apply the laws of another jurisdiction. Unfortunately, this is no uniformity on an international basis in this area.

XIII. Hague Conventions

The Hague Conference on Private Law, which meets in the Netherlands, is an international body that has made several attempts to harmonize the conflicting laws described above.

There are several Hague Conventions that address estate planning issues. These include:

- # 11 Hague Convention on the Conflicts of Laws Relating to the Form of Testamentary Dispositions
- # 21 Hague Convention Concerning the International Administration of the Estate of Deceased Persons
- # 25 Hague Convention on The Law Applicable to Matrimonial Property Regimes
- # 30 Hague Convention on The Law Applicable to Trusts and on Their Recognition
- # 32 Hague Convention on the Law Applicable to the Succession of Estates

Unfortunately these have not been widely adopted. The United States has not ratified any of the above Conventions. This may be in part a result of these issues being handled at a state level in the United States, and not at a federal level.

→ Tip: Full texts and current status are available on the excellent web site of the Hague Conference on Private Law: www.hcch.net

XIV. Closing Thought

The field of international estate planning contains a fascinating array of conflicting issues and approaches. Unfortunately, little attention has been given on an international level to

develop some predictability and reliability in this important field. At issue, after all, is the disposition of one's entire lifetime accumulation of wealth, and gifts and bequests to one's family and friends.